

Preparing for the Future

CHAPTER 1

In this chapter, we introduce scenario thinking: what it means, why it is valuable, and how it enables organizations and the people within them to focus on achieving sustained competitive advantage.

Overview

This chapter is concerned with preparing for the future, introducing the concept of scenario thinking and its potential value in delivering a world-beating strategy. Understanding how best to achieve competitive advantage, in a world where the only constant is an ever-increasing rate of change, is the key attribute of profitable, market-leading organizations. As the pace and scope of change quickens, the urgency of finding the best, most competitive approach grows. In this context, the core tool to deliver continued success is the development of a new approach to strategic thinking. Tomorrow's successful companies will overturn strategic inertia and business-as-usual thinking, avoiding complacency and finding new, scarce sources of value.

In this chapter we will:

- **Assess the drivers both of organizational success and failure** – understanding that both are inevitable, dynamic and closely tied together.
- **Explain the Sharpbenders research into why organizations fail** – this research highlights problems in store for organizations that are inherently unable to detect or respond to change.

CONTINUED... Overview

- Use case examples to outline the problems in maintaining organizational performance – knowing where organizations go wrong, how and why, is essential in forming an approach that will deliver sustained competitive advantage.
- Highlight the factors that are critical to achieving success – explaining how the barriers to success can be overcome, notably by creating lasting value.

The business environment is not a static arena. Establishing an ongoing, scenario-based strategic thinking process enables a business to plan for change, achieving optimum performance. These concepts are introduced in this chapter using several case study examples: Xerox and Canon, Yahoo!, Lego, Tetra Pak and Nokia.

UNDERSTANDING ORGANIZATIONAL SUCCESS**Success and Failure are Inevitable**

This book is ultimately about organizational success. Organizational success is inevitable: there will always be successful organizations. Equally, organizational failure is inevitable. Organizations operating in the world are like football clubs playing in a competition: they cannot all win and they cannot all lose. Success and failure go together like the positive and the negative poles of a magnet; you can't have one without the other.

Most managers work towards the objective of making their own organization successful. Right from the start we know that they cannot all end up where they want to be. That thought has aspects that are both depressing and uplifting. We know that, however hard they try, some managers are going to be disappointed, and each of us should wonder: 'Could I be that manager?' On the other hand, knowing that everything is relative helps us to realize that the task ahead is not impossible. We do not have to be perfect, only better than the competition.

Success and failure are dynamic notions

If there is one thing we can all agree on, it is that the world around us is subject to constant and considerable change. It is clear that organizations operating success-

fully one day may fail totally the next. No matter how illustrious an organization's history might be, all rely on their *future* business. The game does not remain the same. Winning means changing the way one plays over time. Organizations that want to survive have to adapt. The challenge is that the way that the game is changing remains uncertain until it is played. This is fundamental: without uncertainty everyone could do the same calculation, or act in the same way. However, it is important to remember that not everyone can win at the same time: there are winners because there is uncertainty or, to put it in a more positive way, without uncertainty there can be no winners. Instead of seeing uncertainty as a problem, therefore, we had better start learning to love it as the basic source of our future success.

There are winners because there is uncertainty; without uncertainty, there can be no winners. Therefore, instead of seeing uncertainty as a problem, we should start viewing it as the basic source of our future success.

This is highly relevant to this book. We will explain how organizations that lose show poor performance due to thinking and behavioural flaws that can be improved by the use of scenario thinking. Certainly, everyone can discover this for himself, and if we were ever to reach a stage where this had become clear to all managers and every one of them was a scenario planner, there wouldn't be much competitive advantage left in it! At that stage it would have become a qualifier; something no organization could do without. But the fact is, we are far from that state of affairs. Meanwhile, as managers and organizations are slow to discover the fundamental importance of scenario thinking, early adopters can gain huge advantages.

Understanding success by understanding failure

Understanding that success and failure exist together, in close relation to each other, means that the study of organizational success starts with the study of organizational failure. Remembering that the quality of performance is relative, we will try to identify what people and organizations do that makes them end up on the losing side. Understanding weaknesses will help us to turn them into relative strengths.

In this chapter, we analyse what creates failure. This will lead to the notion of 'flaws', which we find at the level of individual thinking, organizational behaviour and community thinking, based on shared cultural beliefs and assumptions. In Chapters 2, 3 and 4 we will analyse flaws at these three levels in some detail.

We will approach the analysis from the perspective of the scenario planner, who for us is the practising manager. It is our belief that scenarios are the most powerful tools that managers have at their disposal today to move their organization to the winning side. In order to make that case, we need to understand the flaws and how they come about. In order to get us there we will first analyse organizational failure.

Explaining the Sharpbenders Research: Why Organizations Fail

In this section, we are going to make use of a body of interesting research highlighting the problems for organizations that are inherently unable to detect or respond to change. This is known as the Sharpbenders research². The people who undertook the research had the bright idea of concentrating on companies that had been failing, as manifest in a stock value that had been slipping against the market average, but which had been able to turn things around. That is where the word *Sharpbenders* came from – a slipping stock value followed by a recovery. The idea was that these companies, having been able to turn things around, would be able to articulate what had gone wrong and why this had happened. After all, if they had managed to turn things around they must have made a successful diagnosis of what went on during the downward part of their history. Having identified such companies from stock market records, the researchers then interviewed many of them and thus produced what is effectively a list of what can go wrong.

The outcomes of the Sharpbenders research

The findings highlight the key causes of relative decline in five categories:

- adverse development in market demand or increased competition;
- high cost structure;
- poor financial controls;
- failure of big projects;
- acquisition problems.

Later, we will analyse these results in more detail. But before we do this we need to introduce a few basic concepts that will help us to navigate this territory.

The difference between hygiene factors and the business idea

The causes of failure identified by the Sharpbenders research can be divided into two categories: *hygiene factors* and *business idea factors*. What do we mean by this?

As we discussed earlier, organizations have always been trying to discover ways of outsmarting the competition. This book is an example of that. Not all ideas that are developed are equally effective, but some stick out as clearly being successful. Initially some organizations develop significant competitive advantage by exploiting these ideas but, over time, others see the beneficial effects and will start to copy the ideas in their own organizations. They can be learned from studying organizations deemed as 'best in class', through a benchmarking process. They will be codified in textbooks and taught to managers. Once an idea reaches this point it has become a *hygiene factor*, something that is generally recognized as fundamental in running any healthy organization. Without hygiene factors, professional management knows in advance that the organization will not have a chance to play in the competitive game.

Most hygiene factors are about the need to ensure sound and efficient business processes, critical to ensure that the organization remains a going concern. These business processes are the generally accepted basics for running any organization; they are qualifiers, allowing you to play. However, winning the game requires much more: additional, distinctive factors and capabilities that will distinguish the winner from the losers. These additional, distinctive factors and capabilities that are not yet generally codified and available only to one organization are summarized in what we call its *business idea*.

The business idea

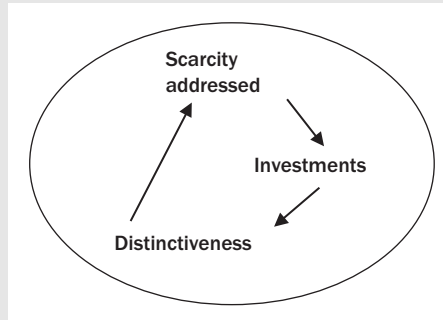
An organization's business idea (BI) can be described as its success formula in the competitive game. We look at three fundamental factors to judge the strength of a BI:

- A BI must be capable of explaining how value will be created for stakeholders of the organization. Without value creation, no organization will be able to survive. We know that value is being created if the BI addresses a scarcity somewhere in society, by filling it or by alleviating its effect. This is what prompts customers to come to the store to buy its products.
- An organization that wants to be able to meet a scarcity in society must have something unique to offer. If nothing is unique in what the

CONTINUED . . . The business idea

organization does, it cannot engage in unique activities and therefore, by definition, not address any scarcity. A BI has to clarify the system of uniqueness that the organization brings to bear on its activities.

- Once an organization makes a unique contribution and creates value it can charge a price for its efforts and in that way generate resources to invest in its survival. A success formula cannot be effective forever. Anything that is unique will eventually be copied, or its value may disappear because people's interests move elsewhere. Therefore, an organization must be able to show how it invests on an ongoing basis in its distinctiveness.



The three factors operate in a loop, which feeds on itself and stands for the survival capability of the formula. We return to the notion of the business idea in more detail in Chapter 8.

Returning to the Sharpbenders research, the first striking observation is that most failures are due to hygiene factors. The following causes are highlighted:

- **Poor controls** in areas such as credit, working capital, budgets, costs, cash flow or quality. This is often due to inadequate management accounts, leading to infrequent and incomplete reports that are late, too complex, too voluminous, irrelevant or incorrect.
- **Immature management style.** Typical examples include an inflexible CEO (chief executive officer), excessive caution, authoritarianism, ineffective delegation and coordination and over-centralization.
- **Failure to create and communicate purpose and the business idea,** both between the top and middle management, and with the workforce.

Another hygiene factor and one crucial business process that frequently gets pushed into the background is a systemic approach to sensing or responding to external change, based on maintaining sound and efficient relationships with all stakeholders. Maintaining relationships with stakeholders – such as shareholders, suppliers and customers – is vital for all organizations, as any of these groups have the power to threaten its existence. Shareholders can decide to invest elsewhere, customers may ‘vote with their feet’; the government can pass unfavourable legislation, and so on. These vital groups have to be kept on board. Their conflicting expectations need to be identified and reconciled.

This book is not about hygiene factors. That does not mean that it is not important to recognize their existence as qualifiers in the race. Indeed, often they are not looked after sufficiently, notwithstanding the fact that professional managers know what needs to be done. Unfortunately, in real life things often slip due to lack of time or attention. If this results in poor performance, the manager has to create a ‘sharp bend’ by applying well-known codified management knowledge. For example, where management accounts are found to be inadequate, effort on getting these up to standard pays significant dividends. Similarly, inadequate internal communications leading to a poorly motivated workforce will offer significant scope for improving results with a relatively modest and obvious upgrading project. There are many examples where hygiene factors have to be considered and addressed with the application of codified knowledge in order to ensure success.

This knowledge is available, for example, in business schools and in textbooks, and help is at hand from the many consultants who offer their services in these areas. In this book, however, we will concentrate on where winning business ideas come from. Our focus here is on longer-term strategy.

Looking after hygiene factors should be seen, therefore, as a minimum requirement to play, a qualifier for being in the game. However, the ultimate aim is to try to win. For this, the organization needs a unique business idea. The Sharpbenders research shows interesting failures in this area as well.

The Sharpbenders business idea failures

The strategic reasons for failure identified in the Sharpbenders research include:

- A lack of recognizable strategies in such areas as functional policies, corporate strategy and environmental monitoring.

- Poor execution or timing of responses to developments such as declining market demand or increasing competition.
- Inappropriate risk-taking, in terms of projects that are too large in relation to the size of the organization taking them on, or acquisitions that are assessed too optimistically.

In considering these causes of decline, we see clear evidence of organizational inability to understand and adapt to change in their environment. In retrospect, people identify changes in the marketplace that passed unnoticed at the time. Typical examples include new products and new substitutes coming on the market, changes in product technology, demographic changes, changes in income distribution, changes in fashion, and a cyclical fall in demand that wasn't taken seriously.

Similarly, increased competition often went unnoticed, while in retrospect the signals were obvious, such as technological change lowering rivals' costs, threats from substitutes keeping prices low, political changes related to loosening of regulations, trade barriers and purchasing policy, removal of protection and other barriers to entry, a significant new entry, high exit costs keeping competition intense in the face of falling sales, a lack of strong product differentiation or strong cost advantage, or falling switching costs for customers.

Turning things around

The Sharpbenders research findings also show the managerial actions that were successful in reversing a decline in organizational performance. The business idea-related strategic factors that were identified in the research included:

- An emphasis on customers and their dynamic value systems.
- A strong marketing focus.
- A clear product focus with a deliberate concentration on what the organization can do best.
- Regular reviews of strategy (the danger of formalizing this process tends to increase with the size of the business).
- A forward-looking approach which invests in the future through plant, equipment, research and development (R & D) and training.

Several themes stand out from these issues. First, there is a *lack of exploration of the environment* and its potential or actual impact is not sufficiently recognized.

Second, there is a *lack of understanding of how the wider environment is impacting customers, their needs and value systems*, and whether the organization's products or services continue to create value for them. Let's consider a number of examples where these forces can be seen at work.

MAINTAINING ORGANIZATIONAL PERFORMANCE: PROBLEMS

Sustaining Competitive Advantage – the Battle of Canon and Xerox

Background³

Consider the example of Xerox, who in the early 1970s held a *95% market share* of the global photocopier industry. Its target customers were large corporations and its concept of customer value was that of centrally controlled photocopying. Xerox focused on manufacturing and leasing complex high-speed photocopiers, using its own manufacturing and sales force to provide a complete package to those who leased its machines. Then came along Canon – who competed head-to-head for Xerox's large corporate customer base. The case below sets out what happened, and the key question to consider is this: why didn't Xerox appreciate the nature of the threat and respond earlier than it did to Canon's attack?

In 1956 Chester Carlson, inventor of the electrostatic process that led to the birth of the copier industry, sold his patents to the Haloid Corporation which changed its name to Xerox in 1961. The 914 copier (named because of its ability to copy documents 9" × 14" in size) was introduced in 1959 and heralded Xerox's emergence as the dominant force in the copier industry. The first of its kind to make both multiple copies and the fastest number of copies per minute, the 914 opened up the era of mass copying. Xerox seized the initiative by inventing a business idea targeted at large corporations requiring high-volume copying. The results were spectacular: by 1961, only two years after the introduction of the 914, Xerox became a Fortune 500 company. *Business Week* displayed the 914 on its cover and *Fortune* magazine declared the 914 to be 'the most successful product ever marketed in America'. In 1968, Xerox achieved \$1 billion sales, the fastest organization to reach that landmark at that time. The word Xerox became synonymous with copying: people did not copy documents, they *Xeroxed*.

Xerox wasted no time in globalizing its business idea. It created a joint venture in the UK to form Rank Xerox, which dominated the European market.

Rank Xerox and Fuji Photo Films in Japan created another joint venture, Fuji Xerox, which came to dominate the Asian market. By 1970, Xerox held a 95% market share in the global copier industry.

Then Canon, a Japanese multinational and an industry newcomer in the mid-1970s, created entirely new market segments for copiers not served by Xerox in the USA: small organizations and individuals. In the late 1970s Canon designed a value delivery system offering a \$1000 personal copier to target these segments. For almost a decade, Xerox largely ignored this new business idea that Canon had chosen to develop. In fact, in 1978, Fuji Xerox was willing to sell low-end copiers to Xerox to counter-attack Canon in the USA, but Xerox refused the offer and Canon prevailed.

Canon's ability to attain leadership in low-end copiers illustrates another vital issue in any business idea that can be impacted by scenario planning. This is the power of changing the rules of the game by radically redefining the customer base, based on a previously unattended and growing customer value – in this case, personal control in a distributed system.

Two strategies compared: Xerox's big copier business model

Xerox's decision to serve large corporate customers allowed it to build a business model with huge entry barriers. Xerox had more than 500 patents that effectively prohibited new entrants, and with their massive duplicating needs, corporate customers preferred big scale-efficient machines of the type provided by Xerox's technology. Patents effectively prohibited new entrants.

Furthermore, the high cost of salesforces deterred competitors. By focusing on corporate customers, Xerox could build a direct salesforce, since it had a limited number of customers to service. By 1970, Xerox had created an enviable salesforce with technical expertise, long-term customer relationships and deep product knowledge. New entrants wanting to copy its business model would have to replicate their sales network: this was a high fixed-cost activity and thus another major entry barrier.

Finally, the large investment cost of providing a specialized, 24-hour service network acted as an impenetrable barrier. Xerox's customers, primarily Fortune 500 corporations, did not care as much about price as they did about the need for reliability. Because central copy centres typically had one large machine, the entire centre came to a standstill when the machine broke down. It was not enough for Xerox to offer excellent service: it had to guarantee outstanding 24-

hour service. By 1970, Xerox had built a world-class, round-the-clock servicing capability. This proved to be another formidable entry barrier, and this, coupled with the brand name, simply overwhelmed new entrants.

These factors posed significant problems, even for an established office equipment supplier like IBM. Certainly, IBM faced an insurmountable barrier in the form of technology patents. It was a contender to challenge Xerox as it sold computer mainframes to corporate customers through a salesforce and serviced them through an extensive network as early as the 1960s. However, IBM's sales and service staff could not easily be transferred to the copier market without further, significant investments in technology and product training. Because of these factors, Xerox enjoyed a virtual monopoly in the copier industry.

Canon's response: the distributed copier business model

Canon focused first on *overcoming the problem of patents*. It dedicated its research efforts during the 1960s to develop an alternative to Xerox's patented technology. In 1968, it invented the *New Process* (NP) technology, which used plain paper to photocopy but did not violate Xerox's patents. Canon deployed two of its existing competency bases, microelectronics (from its calculator business) and optics and imaging (from its camera business) in developing NP technology. Further, it benefited from a 1975 USA Federal Trade Commission ruling forcing Xerox to licence its dry-toner PPC technology freely to competitors.

The next line of attack was Canon's ability to *redefine the customer base*. In the late 1970s, Canon successfully designed personal copiers at a price significantly below Xerox's big copiers, appealing to small businesses and individuals. Canon's personal copiers, which made 8 to 10 copies per minute, ranged in price from \$700 to \$1200. In contrast, Xerox's high-speed machines, which made 90 to 120 copies per minute, had a price range of \$80 000 to \$129 000.

Rethinking distribution was the next area of focus for Canon. Because its target segments involved millions of customers, it could not effectively use the direct salesforce approach. Instead, it chose to distribute its personal copiers through traditional third-party distributors: office product dealers, computer stores and retailers. This distribution approach not only eliminated Canon's need for a huge cash outlay but also allowed it rapid market entry.

Challenging the need for a costly service network was the next hurdle that Canon faced, and its next area of innovation. In fact, they overcame Xerox's formidable advantage in 24-hour servicing in several ways. First, because of the inverse

relationship between product reliability and the need for service, it designed its copiers for maximum reliability. Each copier had just eight units that could be assembled on an automated line by robots. Second, it made replacement parts modular so that end-use customers could replace them when they wore out, removing the need for a service network. Copier drum, charging device, toner assembly and cleaner were combined into a single disposable cartridge that the customer could remove and replace after 2000 copies. Third, Canon's design was so simple that traditional office product dealers could be trained to make repairs. Finally, the Canon model enabled people to use other departments' machines when theirs wore down. Unlike with central copying, 24-hour service was not required.

Canon's effect on the copier industry was similar to its earlier, redefining effect on the camera industry. Another key element of Canon's approach was their success in *leveraging their strong brand reputation* for high quality and low cost in the camera industry, benefiting its business when it launched personal copiers.

Sustaining competitive advantage by avoiding flawed, business-as-usual thinking

One of the core values of scenario thinking is its ability to avoid conventional approaches that may be outflanked by a competitor but, instead, invent new business ideas. An important factor here is reaction time and the need to get there before anyone else. This is highlighted by the potential reasons for Xerox's delayed response. There might be several reasons why Xerox did not respond soon enough to Canon's attack with its own version of distributed copying. It might not have perceived Canon as a serious threat because Canon did not initially go head-to-head against Xerox. Perhaps Xerox simply did not expect low-end copiers to become a huge market segment. In fact, during the 1970s Xerox was more worried about IBM and Kodak, which entered the copier industry at the high end by playing by Xerox's rules. Big machines had a high profit margin per unit, whereas personal copiers had a low one. Xerox might have feared the effect of cannibalizing its high-margin business for low-margin copiers. It had invested heavily in a salesforce, which probably would not have welcomed the use of third-party dealers to sell personal copiers that would compete with big

Scenario thinking enables businesses to avoid conventional approaches that may be easily predicted and parried by a competitor, allowing new business ideas to be invented instead. Swift reaction times and the ability to get there before anyone else are vital.

ones. Similarly, Xerox's service network, which operated as a profit centre, had little incentive to support programmes to produce quantum improvements in product reliability. Moreover, under the leasing policy, Xerox had not fully recovered its investment on its installed base, so it was unlikely to want to risk making that base prematurely obsolete by offering personal copiers. Finally, Xerox's customers, heads of copy centres in large corporations, were critical to Xerox's success and so might have had an important influence in its internal decisions. They would naturally resist the introduction of distributed copying for fear of undermining their own position.

Therefore, strong and dominant though they appeared, Xerox had inherent vulnerabilities in its structure and business thinking: an inability to see how potential threats could arise, possibly from a redefining of the industry, highlighted by conventional, business-as-usual thinking and organizational inertia. This situation might have been exposed through a process that considered radically different future scenarios.

Yahoo! – Competing in Fast-moving Markets

Background⁴

Yahoo!'s meteoric rise to success was matched by an equally spectacular downturn in fortunes. Its rise and fall demonstrates the disastrous consequences that can follow when an organization fails to *plan for changes in markets and customer values*.

When AOL (America OnLine) announced its intended purchase of media giant Time Warner in January 2000, Yahoo! was caught completely unawares. However, Yahoo!'s troubles actually started much earlier, with its failure to *develop and constantly update strategies*, which left it completely unprepared for future changes.

Yahoo!'s main competitor for Internet advertising space, AOL, bought media giant Time Warner, with its vast array of magazines, movie studios and book publications. AOL saw considerable benefits in a tie-up with an old-time media giant, but Yahoo! decided not to follow suit. Its *competitive thinking was flawed* – and this led to disaster.

Three individuals had driven Yahoo's early success and they felt invincible. However, *they did not anticipate* – in this case, they did not anticipate the loss of interest from advertisers due, in part, to the dot-com bubble bursting and, in

part, to a growing perceived need from its customers for integrated advertising campaigns – including the Internet, TV, radio and magazines.

Yahoo!'s CEO, Timothy Koogle, president, Jeffrey Mallet and co-founder, Jerry Yang, met to discuss their reaction to the AOL/Time Warner announcement. It is easy to comment with hindsight about the errors in judgement made in this meeting and about how they proceeded to compound these mistakes over the following year. It is also undeniably true *that the organization was impacted by external factors* other than its competitive position in relation to AOL/Time Warner (factors that also affected AOL and others in the industry). However, Yahoo!'s fortunes went from bad to worse, with revenues plummeting 42% in one quarter and market capitalization falling 92%, resulting in redundancies and, over time, in the CEO's departure.

Analysing the Yahoo! example

The story of Yahoo! is a warning for every business, not only start-ups or technology organizations. The source of its problem was its inability to compete and move with the market – or, put another way, its difficulty in planning for the future in a rapidly changing environment. Was there anything that Yahoo! could have done to prevent its problems? It could be argued that if Yahoo! had properly *anticipated and planned for various eventualities*, even ones that seemed unlikely or unthinkable, it would have been better able to weather any storm that tore through their industry. On this basis, we will argue that scenario planning would have highlighted the potential pitfalls of, and solutions to, an over-reliance on advertising revenues. This anticipation could have been achieved in a number of ways.

Clearly understanding internal weaknesses

Yahoo! had a number of internal problems that left it inadequately prepared for the external problems that were about to change its fortunes. Fundamentally, it failed to anticipate the actions of competitors and develop contingency plans for various scenarios, which would have allowed it to respond quickly to competitors.

Ensuring effective leadership

The first internal problem was the leadership of the business. There was a consensus style of management that dulled the decision-making process; a clash of opinions between the CEO and the president allowed the organization to stray off-course, and the lack of a clear and united direction from senior executives left

other staff confused and demotivated. In addition, the CEO's distant style of management meant that the organization lacked the strong leadership it required. In visioning the future and getting everyone involved, effective leadership is vitally important.

Building a positive organizational culture

Closely linked with the need for effective leadership is another major area of difficulty: organizational culture. Yahoo! did not invest in the future, preferring instead to live for the moment. Mallet admitted that if a customer was not prepared to enter into an immediate advertising contract with them, then Yahoo! was not interested in spending any time on developing a relationship; it simply moved to the next customer. This policy may have worked in the early, pioneering days of Internet businesses, but was not appropriate as the market became more sophisticated. Yahoo! failed to appreciate the value of building long-term relationships with clients in increasingly customer-focused markets. This requires time, effort and planning – all factors that rely on leadership and a focus on the right priorities. Yahoo! had failed to respond to, let alone plan for, changes in customer needs. When companies were looking for coordinated advertising campaigns, Yahoo!'s limited offerings of banner advertisements looked inferior and poor value.

Keeping close to their customers

Yahoo! lost sight of its customers, and failed to offer a compelling value proposition. If customers could not see the point of advertising online and Yahoo! was not concerned about winning them over, then the business was doomed to failure.

After considerable disagreement at the executive level, the potential purchase of Internet auction company e-Bay was turned down. Yahoo! had rejected the chance to move away from its over-reliance on advertising, which accounted for 90% of their revenues. Almost inevitably, Yahoo!'s fortunes declined as advertising revenue fell with the end of the dot-com honeymoon. In a new, fast-moving market, complacency and an inability to stay close to the market led to a flawed approach. Clearly, the value of scenario thinking in such a situation needs little further explanation.

In contrast, some organizations do manage to change their business idea – Lego, for instance. Here the story unfolds over many years showing that a longer-term, tougher approach to strategic thinking is needed.

Building a Colourful New Future Brick by Brick – the Story of Lego

Background⁵

Lego, a family-owned Danish company, invented the popular moulded plastic building bricks for children's free-form play. This open-ended play system was developed by the founder, Ole Kirk Christiansen, and was extremely successful for many years, but sales levelled out in the late 1980s. Ole Kirk's grandson, Kjeld, took charge of the organization in the early 1990s and saw the changes that had taken place in customer value. In response, Lego bricks were packaged as themed self-assembly toys (themes including Star Wars and Mindstorms), and this repositioning led to a major increase in sales of Lego products. However, in the highly competitive and fickle world of children's toys, Lego's fortunes and future are far from certain. Profits peaked in 1996 and 1997, and then fell precipitously. In 1998, Lego lost almost \$35 million before taxes. In 1999, Lego laid off 1000 people, the first big layoff in company history, but then in 2000, Lego lost \$120 million, on sales of about \$1.1 billion.

Given the size of these losses, it is unclear whether or not things are improving. The leadership of Lego has to manage a situation that often threatens to pull it in conflicting directions. The organization that Kjeld took over was well managed and poised to expand globally – something that has since been realized. But the organization had also become conservative, so much so that even as it grew, it lost touch with its market. This was in contrast to the radical founding spirit of Kjeld's grandfather, Ole Kirk Christiansen. Lego today is as much the result of Ole Kirk's daring in inventing radical new children's toys, as of his grandson's prudence. Once, for a brief moment, Lego changed the way that children played as well as the way they learned to think. Lego has not been that kind of leader for many years.

The challenge at Lego is to try to mix these cultures, and it has a powerful asset: the Lego brand is the seventh most powerful worldwide among families with children, behind only such names as Coca-Cola and Disney. People take Lego seriously, which is a positive start, but that view has also created a burdensome legacy of expectation.

Mature, established organizations in fickle, fashion-conscious industries can be at a disadvantage if they do not leverage their key resources, notably their knowledge, experience and (in Lego's case) their reputation. Again, this is another key aspect of successful business ideas that scenario thinking can inform, facilitate and support.

The priorities for development

The Sharpbenders research highlights the fact that, in many businesses, significant structural changes need to take place in order to maintain competitiveness. The value of scenario thinking is that it can highlight *priorities* for development. There are a number of priorities and salutary lessons emerging from Lego's story.

Developing a customer-focused ethos – and letting go of the past

For many years, Lego's attitudes and procedures were slow to change and develop. This was coupled with an over-attachment to traditional core values that were increasingly out of step with customer demands, endangering the whole organization. Lego was a 'nice' organization that greatly valued their products for what they gave children. For an organization that holds its customers in such high regard, it is surprising that they strayed so far off-course. One problem for Lego seems to have been that it understood and valued its own image of what was 'best' for children, rather than understanding the realities of what their customers were now looking for from toys. However commendable Lego's sentiment was, it was clearly not enough to ensure continued prosperity: *clinging to past aspirations clouded current business acumen.*

Valuing strategy development and executing the plan

Lego is a highly introverted organization. Even its successful decision to link with Lucasfilm to produce licensed Star Wars toys was nearly suffocated in a protracted and acrimonious decision-making process. Lego clearly needs to learn from its past mistakes: namely, it needs to plan now to better control its future. It must learn to integrate a dynamic strategy-forming process into the organization's culture, if it is to avoid repeating the disastrous results of the past. This will not prove an easy task for Lego, as its existing culture is particularly valued and deeply ingrained. *The challenge is to harness everything that is positive and strong*, of which there is much, and align the whole organization with an effective scenario planning culture.

Sensing and anticipating customer needs

Lego's business history depicts a company that, despite making efforts to identify and prepare for changes in customer needs, found itself displaced by a rapidly changing market. Their limited, protracted and reluctant reactions prevented it from reasserting its dominance in the toy industry, moulding a strong, directed future, or optimizing profitability. The lesson for Lego is to formulate, embrace and implement an improved business idea and ethos for strategic thinking.

Despite changes, Lego is still lagging behind its competitors; customers have moved on and it is questionable whether the current Lego products will offer enough to tempt back significant numbers of customers. When the products are toys for children, it is perhaps easy for passion and sentiment to blur the objective of firmly rooting business models in offering a good value proposition and awareness of competitors. Maximising potential can be a dispassionate, analytical affair, especially when an organization's survival is at stake. Lego's deep respect for and commitment to the importance of children's play is an asset that, *when harnessed*, is an invaluable tool to deliver business success. However, without the guiding hand of forward strategic thinking, it is a poor guarantor of future success.

Making difficult decisions

Tough decisions will no doubt be required in Lego's future, but one thing is certain: tough decisions are often easier to take and more palatable and smoother to implement when they have been anticipated and prepared for well ahead of time. This is never truer than when dealing with what is, in essence, a 'family' organization, where emotional attachments can prove an immovable obstacle to change and a misguided or self-delusional indicator to future success. It may be time for Lego to accept that their 'Lego values' belong to a different age: new values need new approaches and a new business idea.

SUCCESS STORIES

Organizations reviewed in the Sharpbenders research all encountered difficulties but managed to regain control over their situations. As we saw, there is much we can learn from these cases about what matters; which factors make the difference between success and failure. However, this also raises an important question: is it possible to see the potential for trouble in enough time so that it can be avoided altogether? To start answering this, it is helpful to consider two companies that seem to have done things right.

Providing Customer Value – the Rise of Tetra Pak

Background⁶

Tetra Pak, a Swedish multinational corporation and part of the Tetra Laval Group, develops, manufactures and sells systems for processing, packaging and

distributing liquid food products. Tetra Pak had only a small share of the paper carton business during the 1970s, yet by 1999 Tetra Pak was producing packaging materials at 57 plants, selling 90 billion containers per year in more than 165 countries, and had captured a 40% share of the European liquid-packaging market. Two brothers, Hans and Gad Rausing, have transformed the organization from a small Swedish milk carton organization into a global liquid-packaging powerhouse.

Tetra Pak succeeded by redefining its industry, effectively changing the concept of customer value in the global liquid-packaging industry. Understanding how this was achieved can help to point the way for other businesses that may wish to consider their own futures.

From traditional to reinvented customer value

Originally, the organization was a niche player focused on one product category: packaging for liquid food items. They did not make other types of cartons, nor did they diversify outside the packaging sector. Growth had to come from global expansion in its product category. Tetra Pak invented a new business idea that altered the traditional model for its industry by offering customers a totally integrated system including filling equipment, packaging materials and distribution equipment (such as conveyors and tray packers). Customer value was transformed from the traditional way, pouring liquids into containers, to Tetra Pak's approach: containers made at the point where beverages are ready to be packed.

Making it happen

The Tetra Pak system delivered two features that were unique in the industry. First, the organization installs their filling equipment in the beverage producers' factories. Second, with Tetra Pak's process, their special vacuum-filling technology keeps air out of the liquids during the filling process, preventing decay caused by light and air in liquid containers. With such an aseptic property, Tetra Pak cartons do not require refrigeration to preserve liquids. Milk has a shelf life of 6 months, juices 12 months. Tetra Pak's business idea has altered the concept of value at every stage of the traditional industry value chain: for container manufacturers, beverage processors, retailers, consumers and finally, and because of these activities, for its own long-term operations.

The benefits of the new system

The Tetra Pak system provides savings in factory space, labour and overhead costs involved in making the containers. It also provides savings in transportation costs, as empty containers do not have to be delivered from container manufacturers to beverage producers. Not only is transportation expensive but also results in breakages during transit. In addition, manufacturers avoid handling and some insurance costs.

For beverage processors, the Tetra Pak approach reduces inventory costs. Cartons are made only when needed, thereby ensuring 'zero' inventories of empty cartons in the pipeline and saving financing costs and storage space. There are lower transport costs: once filled and sealed, the beverages do not require refrigerated trucks for transport to supermarkets, even on long hauls. The Tetra Pak approach ensures an efficient use of space, minimizing storage and transport costs. Whereas bottles and paper cartons cannot easily be stacked on top of each other, the box-shaped Tetra cartons can be stacked up easily and the rectangular, flat structure of Tetra cartons ensures efficient use of space.

Producers also enjoy the benefit of buying complete systems from one supplier – Tetra Pak, with matching equipment at every stage. This provides customers with uninterrupted production. Tetra Pak, in turn, has an experienced and well-trained service force that assures customers fast, efficient repairs and equipment maintenance.

A major value for consumers is the convenience of the Tetra Pak cartons: they are lighter, more versatile, compact, convenient to use, appealing in appearance and competitive in price. In many ways, these customer advantages are the prize: the outcome that must be kept firmly fixed in the mind of the strategist.

The benefits for Tetra Pak's long-term operations

Tetra Pak has found that their system offers clear potential for global expansion in emerging economies like India, China and Brazil. Here, sizable populations living with limited refrigeration facilities are especially well suited to the Tetra Pak system. Without Tetra Pak, these beverage markets would remain largely underdeveloped. Furthermore, Tetra Pak's close relationships with beverage companies have enabled it to dedicate more than 1000 engineers worldwide to focus on customer needs, developing new packaging designs and continuously improving their processing and distribution systems. In this way, Tetra Pak is almost institutionalizing customer-driven innovation, ensuring that future needs

are carefully understood and given a focus that might elude many other businesses. This approach can also be self-sustaining largely because of Tetra Pak's secure revenue position. By leasing its filling machines, Tetra Pak offers customers protection from technological obsolescence. Having locked up beverage companies on long-term machine leases, Tetra Pak enters into contracts with customers to supply them with packaging materials at attractive margins. The materials have been custom-designed for Tetra Pak machines, effectively giving the organization a virtual monopoly in providing raw materials to the filling machines. Once familiar with Tetra Pak machines, and having trained employees to operate them, beverage companies have little incentive to switch to other suppliers.

Ideas for reinventing customer value

As the Tetra Pak example illustrates, when an organization redefines its business idea from selling discrete products to selling an integrated system of products and services, customers' dependence on the organization significantly increases. But most customers do not like relying on a single source because the provider has the ability to exploit its resulting bargaining power. From the customer's viewpoint, offering total solutions will be a winning value proposition *only* if three conditions hold.

1. **The solution is best in class** The organization is best in class in every product offered. If not, customer value is reduced because customers can obtain that product from another, superior source.
2. **The solution is seen by customers as being genuinely superior** The integrated solution is genuinely superior to the alternative of customers buying discrete products and services and bundling them on their own. Such superiority can result from one or more of several sources: system design, system assembly and customization of user needs.
3. **The price remains competitive and the gains are shared** The corporation offers the bundle at a price lower than the price customers would pay to assemble the individual products from separate providers. The business should not only demonstrate that the bundle is superior, *but also be willing to share its gains with customers.*

Tetra Pak's success has been the result of paying careful attention to all three of these conditions for providing customer value. Of course, this is no guarantee for

the future and, sometimes, things can go wrong. However, the Sharpbenders research findings suggest that with its intense focus on customer value, Tetra Pak is likely to prosper. Even so, with strengths and weaknesses being relative notions, it must find new ways of understanding and anticipating the evolving nature of the customer value landscape.

The same applies to Nokia.

Entering New Markets and Maintaining Growth – Nokia Answers the Call

Background⁷

Nokia has generated impressive growth, driven by innovative mobile phones and some of the industry's lowest production costs. In 1990, the organization sold more than \$600 million worth of cellular phones; by 1995, its phone sales exceeded \$4 billion, and by 2001 Nokia had become Europe's largest company. Nokia captured the second-largest share of the cellular phone market both around the world and in the USA. In just a decade, Nokia has gone from selling no cellular phones in the USA to controlling nearly 20% of a market estimated to be worth \$5 billion.

The factors behind Nokia's phenomenal growth and its ability to successfully enter new markets lie in some of the fundamental benefits of scenario planning. These are the importance of scenario thinking in improving reaction times, as well as the impact of scenarios in developing a corporate culture and ethos that promotes thinking through uncertainty, towards achieving a superior business idea.

Reasons for Nokia's growth

In the late 1970s, Nokia was a conglomerate making toilet paper, rubber boots and power cables, mostly for the Finnish market (Finland has a small population of about five million). Nokia's chief executive during part of the 1980s, Kari Kairamo, bought four European colour television manufacturers and a large Swedish computer manufacturer. The acquisitions pushed Nokia's revenues up 56% in 1988 to \$4.4 billion. However, while Nokia was a major European player, it was still too small to compete in markets that were increasingly global, and its profits plunged.

The need was clear: Nokia needed to *focus* its business in areas where it would achieve greatest profitability and success. In late 1988, Nokia decided to dispose of its traditional, mature businesses, because it had several other businesses that were suddenly doing very well: telecommunications equipment and cellular

telephones. That was where its new focus was directed – and at just the right time.

The next underlying reason for its growth was Nokia's ability to *sense market developments*. The breakthrough came when the telecommunications authorities of Sweden, Denmark, Norway and Finland decided to build the world's first international cellular system. As Sari Baldauf, head of Nokia's cellular systems division, said: 'Some of the big telecommunications companies thought wireless was a pretty small market niche, but we saw it as an opportunity.'

When the Scandinavian system was switched on in 1981, Nokia was there with both equipment and phones. This positioning ensured that Nokia was able to expand with the massive growth in the telecoms industry that took place during the 1980s and 1990s. In the USA, a commercial cellular service began in 1983, and Nokia was again ready to supply phones. However, it faced a major problem: how could a relatively unknown Finnish company break into the US market? The answer lay in *understanding the benefits of strategic partnering*. Kari-Pekka Wilska, head of Nokia's USA operations, recalls, 'We didn't have the money to do it all ourselves.' In order to penetrate the American market, Nokia offered high-quality products and entered into a major alliance with the Tandy Corporation. Nokia produced mobile telephones that were then sold via 6000 Radio Shack outlets in the USA. It was an inspired pairing. Nokia had learned its skills in Scandinavia, where technological innovation was imperative. Tandy brought a new set of priorities. 'For Tandy, the first priority was cost, then it was cost, and then it was cost, and then came something else,' said Pekka Ala-Pietila, president of Nokia's mobile phones division. Nokia learned how to cut manufacturing costs to the bone.

Nokia proved to be a quick organizational learner. For example, from Tandy the business quickly learnt the importance of *high volumes* and *low cost*, two further factors that proved crucial to its growth and success. One of Nokia's strengths was that its new portable phone was designed for production in large volume. Even though cellular systems differ between countries, designing a new phone that is almost identical wherever in the world it is sold is advantageous because when a product is modularized, it can be easily converted or mass-produced. Nokia recognized that it had to produce enormous volume to write off its manufacturing overhead – and this has put them far ahead of other companies.

Nokia's positive story points to factors necessary for growth and sustained profitability. The issue here is that the factors that drive successful strategies can be consciously addressed and developed using scenario planning.

BARRIERS TO STRATEGIC SUCCESS

Lessons Learned

These examples highlight similar points about effectively formulating and executing business strategy. From all of these points, the importance of scenario-based thinking and scenario planning becomes apparent.

Remember the value of anticipation in strategy formulation

Like Tetra Pak, Xerox had a very strong business idea. But in Xerox's case, the very strength and invulnerability of the business idea was its undoing. Xerox was shackled (by its own salesforce and its leasing policy) to its big machines. It could not afford to offer smaller machines to its customer base. It thought that its customers, heads of copying in large corporations, would protect both themselves *and* Xerox and retain centralized copying, since it was in both their customers' and Xerox's interests. Other parties trying the same business idea found that it could not be copied. However, individuals working in those large corporations increasingly wanted the flexible and instant access to copying facilities that Canon technology offered.

Similarly, Motorola was unprepared for Nokia's entry into the US mobile phone market (as we said above, first Nokia made phones for Radio Shack and then sold its phones with a well-known carrier brand stamped on them). Nokia's strategy was to design phones that were user-friendly and modularized – such that even though cellular systems differ from country to country the basic phone was almost identical, no matter where in the world it was sold. Enormous sales volumes of almost identical products allowed Nokia to reduce its manufacturing overheads and unit costs.

Both Xerox and Motorola felt invulnerable, and then the worst happened: a competitor came from nowhere and established a stronghold, based on evolving customer value. They were unable to anticipate what would happen. This was also evident in the case of Yahoo!, as its failure to predict and plan for any market changes left it out of control, reeling on a reactive course rather than pursuing a profitable, proactive route.

Yahoo! highlights how difficult it is for an organization to survive, let alone prosper, when it continually acts in an *ad hoc* manner. Yahoo!'s style could be characterized as permanent troubleshooting; hurtling from crisis to crisis. Situations would present themselves and *then* corporate policy would be discussed and

decided. This not only slows reaction time, giving competitors time to dominate the market; it also increases the possibility of making disastrous errors in judgement.

It would be wrong to ascribe Yahoo!'s failures to a few changes in market forces. Rather, its failures can be clearly seen in its inability to plan for possible future events. With the vision and will to implement scenario planning and anticipate developments, its future might have been different.

Challenge current strategies, existing norms and avoid an over-reliance on traditional assumptions

Some organizations, however, are better able than others to see that the future will not be like the past. They understand that the organization's business idea needs to adapt and be kept closely aligned with changes in the world. In the case of Xerox versus Canon, Canon first identified an unmet need, indicating a new market segment and then, having a foothold, it was able to compete for business from Xerox's corporate clients and better meet these clients' changed needs for distributed copying facilities. The simple conclusion: Canon was able to satisfy changes in customer values. Nokia, by contrast, focused on volume production of standardized products, while Motorola seemed unable to appreciate the medium-term significance of Nokia's early adherence to a low-cost production strategy. This proved a winner in the mobile market, with lower cost the overwhelming customer need.

In the case of Yahoo!, the three-person management team seemed to believe that the future would be like the past: markets would remain largely unchanged and their offering of online ads would continue to satisfy customer value. Clearly, this was a failing strategy that, very soon, had to be reversed.

Guard against current success clouding the future

Why did Xerox fail to see how Canon was redefining the copier market? Why were Yahoo!, Lego and Motorola unable to see the impact that new designs, alliances and technology – or simply changing trends – would have on their current success?

The reason is that all these companies, and many, many others, are the prisoners of their own success. Ways of operating became ingrained in companies over the years – this is something for Tetra Pak to think about. Also, dominant

management figures can stifle innovation and new thinking within an organization.

A organization's offering must satisfy the moving target of customer value

Tetra Pak seems to have achieved this. In contrast, Xerox, Lego, Yahoo! and a range of other corporations were less able to keep pace with and then satisfy shifting customer values. Business-as-usual thinking, and reliance on previously successful business ideas, can lead to organizational decline, when customers' values change.

Strategy is complex – and it matters

It is easy, with hindsight, to see these flaws in thinking for what they are – flaws – but a more interesting and relevant question might be, why did the management teams of these large and powerful organizations not see the inevitable sooner? Why were they unable to realign themselves with the changing world? Indeed, were these organizations sensitive to the changes that were taking place? How did the successful businesses manage to vision a profitable future, clearing hurdles and barriers to entry and achieving success?

Creating Value – The Difference Between Success and Failure

Let's try to bring together the various strands of the examples we have considered. What connects all these cases and the Sharpbenders research is the pre-eminent importance for the winning organization of *creating superior customer value*. Winning manifests itself in terms of the surplus created for an organization that can be invested into its future. Tetra Pak created so much value that it could offer a highly attractive deal to its customers while keeping enough for itself to ensure its future. Lego had lost its ability to do so, at least in 2001. Xerox at one time generated so much value that its future seemed assured forever, but then value moved somewhere else, where Canon had a better fit. So, value is the crucial starting point. But where does value come from? And since it is continually evolving, how can it be identified, in the present and in the future?

It is useful at this stage to look at economics, where it is argued that value is always associated with scarcity. There is little or no value in providing something that is in plentiful supply from other sources. The best you can hope to achieve is to recover your costs without achieving much of a surplus. After all, customers do

not have to come to you, and with many alternative competing suppliers, any possible surplus will quickly be competed away by existing players or newcomers. This does not happen in an area of scarcity, where there are no alternative suppliers. Here, the customer will judge the value of the service not by what other suppliers have to offer, but by the additional costs they incur if the service is not provided at all. To the extent that these extra costs of doing something else are in excess of the cost of providing the service, a surplus is created that can be shared between the supplier and the buyer.

Value is Created in a Domain of Scarcity

At one time, cheap photocopiers were scarce, and Xerox could respond to this. Then Canon managed to push costs down to a level where personal control became an overriding value. At one time, the need for banner advertisements on websites seemed inexhaustible. After the dot-com collapse, the need moved to more integrated approaches. Sell-by dates is a severe bottleneck for the beverage industry, so overcoming this by inventing new packaging techniques creates huge potential customer value.

Organizations that want to connect or reconnect with customer value have to explore this scarcity landscape, now and in the future. They have to ask themselves: where are the current bottlenecks in the economic and social system, and where are they likely to evolve towards? In our finite world, there will always be bottlenecks, but they won't remain in the same place. Current areas of scarcity will become abundant tomorrow, and the bottleneck areas will have moved elsewhere.

Strategy requires that we map out this future scarcity landscape, and scenario planning is an invaluable tool for achieving this. The examples show clearly that organizations have difficulties dealing with this make-or-break question. Also, the Sharpbenders research shows that few organizations seem to have this essential exploration of the business environment on their conscious agenda. There seem to be powerful barriers stopping people from doing the obvious.

SUMMARY: UNDERSTANDING THE BARRIERS TO SCENARIO PLANNING

Scenario exploration of the business environment is a scarce resource. This makes using scenarios a powerful business idea, but the bottleneck is not on the supply

side. Scenario methods are neither difficult nor new – in Chapter 5 we will show that scenarios have been around for hundreds of years. There is enough help available. The reason why people stop short of using the obvious tools for the development of future strategy is not in their availability, but in the *thinking flaws* that stop them from engaging in this exploratory activity.

We have argued that the future of organizational success lies in understanding the future of scarcity; understanding where the bottlenecks lie. In the case of scenario planning, this means understanding the thinking flaws that act as barriers to entry in this domain. We should now consider these thinking flaws in further detail. We have identified thinking flaws at three levels in society: individual, organizational, and the level of communities and cultures. Examples of these barriers at work can be clearly seen in our case studies. In the case of Lego, decisions remain highly personal affairs in this family-owned organization. We can see how, after an initial period of innovation, the decision-makers get stuck in a trial and error approach that has its roots strongly in a *business-as-usual* way of thinking. Much the same situation existed at Yahoo!, where decisions were personally determined, and the few individuals at the top clearly had a problem with stepping out of the limited thinking box that they had built for themselves. Xerox is a case of organizational thinking flaws. The organization had been so successful that a form of group-think had entered the internal strategic conversation. Living in this environment, it had become extremely difficult to even raise the possibility that its business strategy was wrong. We would argue that the Xerox case is also a good example of the effect of culture on thinking. Xerox thinking was strongly based on an American corporate 'world-as-a-machine' view, where emphasis lies on making the machine ever more efficient. The more organic Japanese assumptions about the world would more easily bring into focus the value that individuals put on the perception of being in control and getting immediate results.

Our next job is to understand the barriers to scenario thinking, and the underlying flaws causing them. Chapters 2, 3 and 4 will deal with these important issues. In Chapter 2, we consider personal thinking flaws that can stand in the way of sound and vigilant decision-making by individuals. In Chapter 3, we consider flaws in thinking that are caused by interpersonal dynamics in organizations. Even if it was possible to overcome personal thinking flaws, we would still need to pay serious attention to how things may go wrong in this interpersonal domain. Moving up one further step in the system of human interaction in Chapter 4, we will consider the limitations that communities and

Summary: understanding the barriers to scenario planning

societies impose on thinking, giving rise to what is known as the 'culture' of the group. Throughout, we will consider how scenario thinking can be helpful in overcoming these flaws.

